

FNS - Financial Services Training Package

Financial Services Units

Unit

FNSFLT203

Develop knowledge of debt and consumer credit

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Trainer/Teacher Manual



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STUDENT/TRAINEE DETAILS

Student/Trainee Name

Student/Trainee Email

Teacher / Trainer Name

School / Institution / Training Organisation / Employer

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INTRODUCTION

This manual is developed to provide training content that addresses the specific 'Unit of Competency' as outlined on the following pages.

It provides the teacher and/or trainer with a document that includes all that the student and/or trainee manual content plus guidance notes as well as answers to the learning activities in the student/trainee manual.

This manual can be packaged with various manuals addressing other 'Units of Competency' in order to meet the 'Packaging Rules' of a particular Australian Training Package Qualification.

This resource has been designed to be delivered in a form that is conducive to the learning environment including:

- ☆ Online delivery
- ☆ Classroom delivery
- ☆ On the job training

The documents are designed in a 'landscape' format in order to make reading on a computer screen easier as well as reduces the need to scroll down pages. Documents can be easily printed if the learning environment requires the student or trainee to have hard copies of the learning materials.

INTRODUCTION—CONT'D

LEARNING ACTIVITIES

The learning activities in the student and/or trainee manuals are 'Form Enabled' so that if the resources delivered online, the activities can be filled in using the computer keyboard.

Each learning activity is identified with the following icon.

**Learning
Activity**

Learning activities come in the following forms.

- ☆ Questions
- ☆ Research
- ☆ Tasks
- ☆ Interviews

Questions

Questions would relate to the information presented on previous pages.

Research

This type of learning activity would require the student or trainee to locate information by using research methods. The information they would be required to locate would be in line and/or support the information that the manual had outlined in previous pages.

INTRODUCTION—CONT'D**Tasks**

This learning activity type would require the student/trainee to actually do or undertake something and would be reinforcing the knowledge they have gained from reading the manual's previous pages.

Interviews

This learning activity type would require the student/trainee to interview person(s) in an actual workplace environment or a person(s) who are experienced in the industry sector which the student/trainee is currently undergoing training.

The student/trainee is made aware of the type of learning activity by noting the learning activity type displayed under the learning activity icon.

**Learning
Activity****Research****SELF ASSESSMENT**

At the end of each manual is a series of questions that the student/trainee should review and answer.

This self assessment is to ensure in the student's or trainee's mind that they have reviewed and understood the information that was presented in their manual.

The questions in the 'Self Assessment' section are questions that align with the 'Unit of Competency—Required Knowledge'.

If they are unsure of their understanding in any of the topics reviewed, they are encouraged to go back and review the information again and/or seek the assistance of their teacher or trainer.

UNIT OF COMPETENCY OVERVIEW

The following pages are extracts from Training.gov.au website and outlines this specific 'Unit of Competency' including the 'Elements' and the 'Performance Criteria'. The content within this manual has been developed to address this unit.

FNSFLT203 - DEVELOP KNOWLEDGE OF DEBT AND CONSUMER CREDIT

ELEMENT	PERFORMANCE CRITERIA
1. Identify and discuss role of credit in society	1.1 Identify and discuss concepts and terminology of credit provided by financial institute and debt incurred by borrower 1.2 Identify historical and current role of consumer credit in Australian society and discuss advantages and disadvantages of credit use 1.3 Discuss impact of consumer debt on national economy
2. Identify and discuss range of credit options available	2.1 Identify and compare types of credit facilities used by businesses 2.2 Identify and compare types of credit facilities used by individuals 2.3 Identify and discuss differences between unsecured and secured loans 2.4 Explain implications of default on secured loans to borrower
3. Identify and compare costs of using credit	3.1 Compare fees and costs associated with different types of credit options 3.2 Compare features and associated risks of fixed versus variable interest rates 3.3 Identify ways to compare advertised interest rates and effects of fees and charges
4. Identify and discuss effective use of consumer credit	4.1 Identify and discuss ways to avoid excessive or unmanageable debt 4.2 List strategies to minimise fees on credit 4.3 Discuss importance of meeting minimum payments on credit cards 4.4 Identify and discuss ways to avoid credit card fraud
5. Explain personal credit rating and history	5.1 Describe role of credit reference agencies 5.2 Explain purpose and use of credit reference reports in assessing loan applications 5.3 Identify and discuss implications of establishing a poor credit history 5.4 Describe methods of obtaining own credit reference report and discuss right to access the report
Passing Lane acknowledges that the copyright ownership of the above information is the Commonwealth of Australia and this extract has been provided for reference purposes only.	

Section One

Identify and Discuss Role of Credit in Society

DEVELOP KNOWLEDGE OF DEBT AND CONSUMER CREDIT

SECTION ONE—IDENTIFY AND DISCUSS ROLE OF CREDIT IN SOCIETY

INTRODUCTION

There would be very few people in Australia that would not have some exposure to debt.

Whether it be a credit card, car loan, even a student loan; many people have some level of debt.

In this training manual we will learn about 'consumer credit', as well as other forms of debt.

SECTION LEARNING OBJECTIVES

At the completion of this section you will learn information relating to:

- ☆ Identifying and discussing concepts and terminology of credit provided by financial institute and debt incurred by borrower
- ☆ Identifying historical and current role of consumer credit in Australian society and discussing advantages and disadvantages of credit use
- ☆ Discussing impact of consumer debt on national economy

IDENTIFY AND DISCUSS CONCEPTS AND TERMINOLOGY OF CREDIT PROVIDED BY FINANCIAL INSTITUTE AND DEBT INCURRED BY BORROWER

The concept of debt is quite simple. - a person (or business) that uses someone else's money to buy something and is then required to pay them back later, has a **'debt'**.

This is called **'borrowing'** money and the person (or business) is called the **'borrower'**. The person (or business) giving the money to the borrower is called the **'lender'**.

The borrower has to pay them back more than they borrowed and this is called **'interest'**. The amount of interest that the borrower pays is called the **'interest rate'**.

The borrower may not be able to return all the money back all at once, so the lender lets the borrower pay it back in smaller amounts over a period of time. This is called making **'payments'**.

The lender may say to a person (or business) that they will give them a specific amount of money that they can borrow at anytime if and when they need it. What the lender has done is offered the person (or business) **'credit'**.

The specific amount of credit made available is call a **'credit limit'**, or **'line of credit'**.

As soon as a person (or business) takes money from the lender's line of credit, they have just incurred a **'debt'** to the lender (also known as the **'creditor'**).

In Australia, offering 'credit' to people and/or businesses is very big business and the companies that offer credit are called **'financial institutions'**.

Financial institutions in Australia need to be registered with the federal government agency called **'Australian Prudential Regulation Authority'**. (also known as APRA).

APRA sets out the laws and regulations on how financial institutions are to offer credit and lend money to people and/or businesses in Australia.

There are a number of terms used by financial institutions and in the following activities we have you do a bit of research and locate some of the more common terminology.



SAMPLE ONLY**Learning
Activity****Task****LEARNING ACTIVITY ONE**

In the financial services industry, the terminology used can be confronting, confusing and there is an enormous number of them. The Australian Securities and Investment Commission (ASIC) has a website called 'Money Smart'. They have a 'Glossary' of financial terms and their definitions and this can be found at:

<https://www.moneysmart.gov.au/glossary/>

In this activity we want you to locate the glossary and bookmark it. This will be a very handy reference for you in the future.

TEACHER/TRAINER GUIDANCE NOTES

You, the teacher or trainer will need to check and see if the students or trainees have actually found and bookmarked the glossary.

You may want to have classroom discussions where the students or trainees need to visit this website and the glossary.

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IDENTIFY HISTORICAL AND CURRENT ROLE OF CONSUMER CREDIT IN AUSTRALIAN SOCIETY AND DISCUSS ADVANTAGES AND DISADVANTAGES OF CREDIT USE AND DISCUSS IMPACT OF CONSUMER DEBT ON NATIONAL ECONOMY

(Over the next few pages we cover two 'Performance Criteria' points at the same time to avoid repetition)

Consumer credit is 'personal debt' taken on to purchase goods and services. The term is usually used to describe unsecured debt that is taken on to buy everyday goods and services.

Credit cards and most personal loans, are forms of consumer credit. Home mortgage loans are not considered consumer credit as the money is used for an investment into property and the property used as security for the loan.

Consumer credit can be defined in two ways:

- ☆ **Instalment credit** - this is credit used for a specific purpose. The amount of credit provided is a set amount and the payment of the debt is over a set period of time such as monthly payments. This type of credit is usually used to purchase 'big-ticket' items such as cars, furniture, major appliances and so on. The item purchased serves as security in case the consumer defaults on the loan.
- ☆ **Revolving credit** - the most common type of revolving credit is the credit card. There is a set 'credit limit' and this can be renegotiated to be increased. The credit can be used for any type of purchase. The term 'revolving' refers to having the line of credit remaining open and can be used up to the maximum limit repeatedly, as long as the borrower keeps paying a minimum monthly payment.

Generally, credit provided by credit cards is unsecured and this means that the interest rate is higher than most other forms of credit.

Australia has one of the highest level of consumer debt in the world. According to the 'Reserve Bank of Australia', consumer credit in Australia reached \$2913 AUD billion, as of September 2019

To put that in historical perspective, consumer credit in Australia averaged \$913 AUD billion from 1976, until 2019. In 2019 consumer credit reached an all time high of \$2913 AUD billion. (or \$2.9 trillion)

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ADVANTAGES OF CONSUMER CREDIT

The single biggest advantage of consumer credit is the financial flexibility it provides the consumer.

In the past, people and families had to save for months, even years to make major purchases. People and families were also exposed to those unexpected expenses, such as a car breakdown or the refrigerator stops working and this can put significant financial pressure on the people and/or family.

Consumer credit allows consumers to spread out major costs over the course of months, or years, so they do not have to choose between fixing a car and putting food on the table.

The flexibility provided by credit also allows consumers to make timelier investments, such as house repairs, or small improvements. As an example, a house may need urgent roof repairs. Access to credit allows the repairs to be done immediately. Not having the credit available, the repairs could be delayed and more damage would incur.

Although this should not be used as a reason to use credit, consumers can earn substantial benefits by using credit, if they use it wisely.

Many department stores and car dealerships offer customers advantageous financing options, including delayed payments, interest free periods and low interest rates. Many credit cards often reward cardholders with cash-back offers, frequent flier miles and reward points.

For consumers who pay off their credit accounts each month, these rewards amount to free money. A credit card earning frequent flier miles, for example, could end up buying the consumer a free vacation. However, falling behind on the credit card payments will result in higher interest charges than the rewards are worth.

Managing and paying off consumer credit has a positive effect on a person's credit history and credit score.

Financial institutions or other lenders request a credit report that details a consumer's credit history when a consumer needs credit for things such as making general purchases, buying a home, starting a business or purchasing a car. The more responsible you are with credit, the more creditworthy you become.

SAMPLE ONLY

SAMPLE ONLY

DISADVANTAGES OF CONSUMER CREDIT

Access to credit makes it easier to pay for basic needs and cover emergency expenses, but it also simplifies buying expensive products a consumer might want, but not need.

For example, a consumer might walk into a electronics store and see the latest Smart television. Although not needing a new TV, the store offers credit, payment plans and interest free period and this makes the process of buying the TV simple, without the need to use cash.

Psychologists have found that people who paid with credit cards were more impulsive in their purchases.

Psychologists suggest that the credit card shoppers felt less 'pain of payment' than those who paid in cash. Cash shoppers understood they were spending money on a more tangible level and that feeling moderated their spending.

So, the main disadvantage of consumer credit is the tendency to 'overspend'.

The problem with overspending is that it exposes the consumer to a high-interest debt that can cost them a significant amount of money in the long run.

The other disadvantage is the interest rates on consumer credit can be very high and can force consumers to pay back several times the initial value of their purchases.

Not managing consumer credit obligations will result in a bad credit score, making it almost impossible to access credit in the future.

SAMPLE ONLY

Economy



CONSUMER CREDIT AND THE ECONOMY

The economy of any country relies on consumer spending.

This is why some governments do everything they can to encourage consumer spending (and borrowing), including lowering taxes and lowering interest rates. If consumers spend less, the economy is said to have stalled, possibly leading to a longer-term recession.

So consumer credit plays an important part in the Australian economy.

Access to credit leads to an increase in spending, thus increasing income levels in the economy.

However, high consumer debt can negatively affect the health of the economy when it forces consumers to spend less. Consumers start paying down debt, instead of spending.

There is a term called 'household debt'.

This is all the debt that a household may have that includes consumer debt as well as mortgages. High household debt is why an economy begins to falter. Household income may be stretched to the point where paying off the mortgage and the credit cards becomes the priority, far more than spending.

SAMPLE ONLY**Learning
Activity****Task****LEARNING ACTIVITY TWO**

In this Section we mentioned two types of consumer credit. We have listed those below. In this activity we want you to give us a simple definition of each and an example of each.

Instalment credit
Definition**Example****Revolving credit**
Definition**Example****SAMPLE ONLY**

TEACHER/TRAINER GUIDANCE NOTES

Answers will vary, however should in some way contain some of the following information.

- ☆ **Instalment credit** - the amount of credit provided is a set amount and the payment of the debt is over a set period of time, such as monthly payments. This type of credit is usually used to purchase 'big-ticket' items such as cars, furniture, major appliances and so on.
- ☆ **Revolving credit** - the most common type of revolving credit is the credit card. There is a set 'credit limit' and this can be renegotiated to be increased. The credit can be used for any type of purchase. The term 'revolving' refers to having the line of credit remaining open and can be used up to the maximum limit repeatedly, as long as the borrower keeps paying a minimum monthly payment.

SAMPLE ONLY**Learning
Activity****Question****LEARNING ACTIVITY THREE**

- 1) What is the main advantage of consumer credit?

- 2) Department stores and car dealerships can offer benefits to a customer as a result of consumer credit. Tell us the benefits.

- 3) Managing and paying off consumer credit has a positive effect. What is this effect?

TEACHER/TRAINER GUIDANCE NOTES

- 1) Financial flexibility.
- 2) Many department stores and car dealerships offer customers advantageous financing options, including delayed payments, interest free periods and low interest rates.
- 3) Managing and paying off consumer credit has a positive effect on a person's credit history and credit score.

SAMPLE ONLY

**Learning
Activity****SAMPLE ONLY****Question****LEARNING ACTIVITY FOUR**

- 1) What are the missing words in the following sentence?

Access to credit makes it easier to pay for basic needs and cover emergency expenses, but it also simplifies buying expensive products a consumer might _____ but not _____.

- 2) Psychologists suggest that there is one key disadvantage of consumer credit when a customer makes purchases, especially with credit cards. What is this disadvantage?

- 3) What is the main disadvantage of consumer credit?

- 4) Consumer credit can cost consumers a significant amount of money in the long run. Why is this so?

- 5) Not managing consumer credit obligations may result badly. What could be the result?

SAMPLE ONLY

TEACHER/TRAINER GUIDANCE NOTES

- 1) Access to credit makes it easier to pay for basic needs and cover emergency expenses, but it also simplifies buying expensive products a consumer might want but not need.
- 2) More impulsive with their purchases.
- 3) It often leads to overspending.
- 4) It exposes the consumer to a high-interest debt that can cost them a significant amount of money in the long run.
- 5) Not managing consumer credit obligations will result in a bad credit score, making it almost impossible to access credit in the future.

SAMPLE ONLY**Learning
Activity****Task****LEARNING ACTIVITY FIVE**

In your own words describe the importance of consumer credit to the economy, as well as how high consumer debt can affect the economy.

TEACHER/TRAINER GUIDANCE NOTES

Access to credit leads to an increase in spending, thus increasing income levels in the economy.

However, high consumer debt can negatively affect the health of the economy when it forces consumers to spend less. Consumers start paying down debt, instead of spending.

SAMPLE ONLY

Section Two

Identify and Discuss Range of Credit Options Available

DEVELOP KNOWLEDGE OF DEBT AND CONSUMER CREDIT

SECTION TWO—IDENTIFY AND DISCUSS RANGE OF CREDIT OPTIONS AVAILABLE

INTRODUCTION

In this section we look at the types of credit facilities that are available to business and available to individuals, as well as what it means to have secured and unsecured loans.

SECTION LEARNING OBJECTIVES

At the completion of this section you will learn information relating to:

- ☆ Identifying and comparing types of credit facilities used by businesses
- ☆ Identifying and comparing types of credit facilities used by individuals
- ☆ Identifying and discussing differences between unsecured and secured loans
- ☆ Explaining implications of default on secured loans to borrower



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IDENTIFY AND COMPARE TYPES OF CREDIT FACILITIES USED BY BUSINESSES

Businesses require credit facilities for a wide range of reasons and some of those can include:

- ☆ Cover temporary cash flow shortfalls
- ☆ Buy new tools, equipment and/or machinery
- ☆ Buy inventory, or raw materials

It could also include taking out loans to buy facilities in which the business will operate from. Businesses use credit to improve productivity by acquiring new systems, tools or equipment or to expand the business.

We look at the common types of credit facilities that are available to businesses and what they are used for.

- ☆ **Business loan** - this is a fixed amount of money borrowed by the business, for a fixed amount of time and generally paid off in monthly instalments or payments.
- ☆ **Line of credit** - instead of a fixed amount, a financial institution will provide the business a line of credit to a set amount and the business can draw some, or all of it at anytime. The line of credit amount is the amount of what has not been drawn, as well as what payments were made.
- ☆ **Overdraft** - this is an agreed amount that a bank will cover for amounts drawn from the business's transaction account that is over and above what is in the account at the time. As money is deposited into the account, the overdraft amount is reduced. Interest is paid on the amount of the overdraft used.
- ☆ **Factoring** - this is when a business sells their unpaid invoices to a financial institution at a discount to receive immediate cash. When the invoice is paid, the full amount goes to the factoring institution.
- ☆ **Leasing** - many businesses will lease company vehicles, machinery and equipment instead of buying. Most items leased are those that can be replaced with newer models and not suitable for fixed assets.
- ☆ **Hire purchases** - similar to leasing except at the end of the lease term, a 'balloon payment' (final payment) is made and the business then owns the vehicle, equipment or machinery.
- ☆ **Vendor financing** - although this type of credit does not come from a financial institution, it is one of the most used type of credit. Vendor finance (or supplier finance) will supply products or services immediately and expect payment at a later date such 30, 60 or 90 days later.

SAMPLE ONLY**Learning
Activity****Question****LEARNING ACTIVITY ONE**

What are the seven common types of credit facilities businesses could use as outlined in this Section?

TEACHER/TRAINER GUIDANCE NOTES

- 1) Business loan
- 2) Line of credit
- 3) Overdraft
- 4) Factoring
- 5) Leasing
- 6) Hire purchases
- 7) Vendor financing

SAMPLE ONLY

SAMPLE ONLY**Learning
Activity****Interview****LEARNING ACTIVITY TWO**

In this activity we want you to interview six businesses in your local area. They can be any type of business and it is likely you would need to speak with the owner, or a senior manager.

You may need to make an appointment although you would need only a few minutes of their time. Let them know this interview is for a training activity and appreciate their time. You could get an introduction letter from your teacher or trainer.

Have a list of the previously mentioned credit facilities used by businesses handy.

For each we would like you to ask the following questions:

- ☆ What types of credit facilities do they use (you could list out the types we mentioned earlier)?
- ☆ What type do they think is the most important to them?
- ☆ Could the business survive without any credit facilities?

We have provided areas on the following pages to compile your interview results.

TEACHER/TRAINER GUIDANCE NOTES

This will give the student or trainee a very good idea on what types of credit facilities businesses use.

SAMPLE ONLY

SAMPLE ONLY**Business One****Name of Business** _____ **Suburb** _____**Type of business** _____**First name of person interviewed** _____ **Position** _____**Business telephone number** _____**What types of credit facilities do they use?**

--

What type do they think is the most important to them?

--

Could the business survive without any credit facilities? If not, why not?

--

SAMPLE ONLY

SAMPLE ONLY**Business Two****Name of Business** _____ **Suburb** _____**Type of business** _____**First name of person interviewed** _____ **Position** _____**Business telephone number** _____**What types of credit facilities do they use?**

--

What type do they think is the most important to them?

--

Could the business survive without any credit facilities? If not, why not?

--

SAMPLE ONLY

SAMPLE ONLY**Business Three****Name of Business** _____ **Suburb** _____**Type of business** _____**First name of person interviewed** _____ **Position** _____**Business telephone number** _____**What types of credit facilities do they use?**

--

What type do they think is the most important to them?

--

Could the business survive without any credit facilities? If not, why not?

--

SAMPLE ONLY

SAMPLE ONLY**Business Four****Name of Business** _____ **Suburb** _____**Type of business** _____**First name of person interviewed** _____ **Position** _____**Business telephone number** _____**What types of credit facilities do they use?****What type do they think is the most important to them?****Could the business survive without any credit facilities? If not, why not?****SAMPLE ONLY**

SAMPLE ONLY**Business Five****Name of Business** _____ **Suburb** _____**Type of business** _____**First name of person interviewed** _____ **Position** _____**Business telephone number** _____**What types of credit facilities do they use?**

--

What type do they think is the most important to them?

--

Could the business survive without any credit facilities? If not, why not?

--

SAMPLE ONLY

SAMPLE ONLY**Business Six****Name of Business** _____ **Suburb** _____**Type of business** _____**First name of person interviewed** _____ **Position** _____**Business telephone number** _____**What types of credit facilities do they use?****What type do they think is the most important to them?****Could the business survive without any credit facilities? If not, why not?****SAMPLE ONLY**



SAMPLE ONLY

IDENTIFY AND COMPARE TYPES OF CREDIT FACILITIES USED BY INDIVIDUALS

There are a number of credit facilities that can be used by individuals. We go through some of the more common ones below and on the next page:

- ☆ **Personal loans** - a personal loan is generally for a fixed amount used for major purposes. The loan has a fixed interest rate and is paid back in instalments (often monthly payments) over a fixed period of time. This is an 'instalment' type credit facility.
- ☆ **Credit cards** - this is a very common type of credit facility. The credit card issuer establishes a maximum credit limit and the user is allowed to use some, or all of the credit. The issuer also establishes a minimum payment requirement to be paid each month. The user can pay just the minimum, more than the minimum, or pay off the entire amount used. This is a 'revolving credit' type facility.
- ☆ **Rent to buy** - there are retailers that offer products on a rent-to-buy program. A financial institution will provide finance to the retailer who then signs up customers on the program. Basically a customer will 'rent' a product (generally big-ticket items) for an agreed period and at the end of the rental period the customer pays an agreed amount and then owns the product.
- ☆ **In-store finance** - this is where a retailer will offer finance for products they sell in-store. The finance is actually provided by a financial institution and the retailer simply gathers the information from the customer and sends it to the financial institution for approval. Often the retailer in conjunction with the financial institution will offer interest free periods to entice the customer to buy and finance the product.
- ☆ **Buy now pay later** - in recent years 'buy-now-pay-later' finance products have emerged. These are used for buying online and in-store purchases, where the customer will buy the product using 'buy-now-pay-later' finance. The customer then pays four or more equal payments over a very short period of time.
- ☆ **Payday loans** - these are short-term loans that can help a borrower to cover immediate cash needs until they get their next pay. These are small-dollar, high-cost interest loans and payments are typically due within two weeks, or close to the next pay period.
- ☆ **Pawnbrokers** - this is when a customer hands over an item (known as a pawn or pledge) to the 'pawnbroker' who will value it. Then they will provide cash as a loan based on the item's valuation. The customer can redeem the 'pawn' at any time, by paying what was owed and getting the item back. If the customer does not repay the loan during the redemption period, the pawnbroker can sell it to recover the cash.

SAMPLE ONLY

SAMPLE ONLY**Learning
Activity****Question****LEARNING ACTIVITY THREE**

What are the seven common types of credit facilities individuals could use as outlined in this Section?

TEACHER/TRAINER GUIDANCE NOTES

- 1) Personal loans
- 2) Credit cards
- 3) Rent to buy
- 4) In-store finance
- 5) Buy now pay later
- 6) Payday loans
- 7) Pawnbrokers

SAMPLE ONLY

SAMPLE ONLY**Learning
Activity****Research****LEARNING ACTIVITY FOUR**

This is a three part activity.

Part One is you are to do some research and tell us two 'buy-now-pay-later' service providers.

Example One _____

Example Two _____

Part Two is you are to do some research and tell us two 'rent-to-buy' service providers.

Example One _____

Example Two _____

Part Three is you are to do some research and tell us three retailers that offer 'interest free period' finance.

Example One _____

Example Two _____

Example Three _____

SAMPLE ONLY

SAMPLE ONLY***TEACHER/TRAINER GUIDANCE NOTES***

Part One - Most common are ZipPay and AfterPay

Part Two - Rent 4 Keeps, Mr. Rental, Rent to Own, Radio Rentals

Part Three - Most electrical stores, appliance stores and department stores would offer this type of finance

SAMPLE ONLY



SAMPLE ONLY

IDENTIFY AND DISCUSS DIFFERENCES BETWEEN UNSECURED AND SECURED LOANS AND EXPLAIN IMPLICATIONS OF DEFAULT ON SECURED LOANS TO BORROWER

(Over the next few pages we cover two 'Performance Criteria' points at the same time to avoid repetition)

The money borrowed using a credit facility can either be 'secured', or 'unsecured'.

The term 'secured' means that the lender holds some type of security over the amount borrowed; also known as 'collateral'.

The collateral or security held by the lender can be 'seized' and then sold should the borrower fail to pay back the money borrowed from the lender.

For personal loans, such as those to buy a car or other big ticket item, the collateral is generally the item bought with the money borrowed.

In business, the same is true for money borrowed to buy tools, equipment, machinery or vehicles. The tools, equipment, machinery or vehicles become the security for the lender should the business fail to pay back the money borrowed.

In business, overdraft accounts are generally secured using a personal guarantee by a 'Director' of a company or a personal guarantee by the owner of the business. This means that should the overdraft fails to be paid back by the company when required, the owner or a Director is then personally required to pay the lender .

Personal guarantees by a 'Director' of a company or personal guarantees by the owner of a business is a common type of security, especially relevant if the company or the business fails and ceases to trade.

Other types of security that a business may be required to provide can include:

- ☆ Security over inventory
- ☆ Security over future income/invoices
- ☆ Collateral using assets of the business/company

Conversely, unsecured loans are just that. The lender has no collateral or security from the business or the individual for money borrowed. This is often the case with credit cards and 'buy-now-pay-later' lending services.

The only option the lender has is to start debt collection proceedings.

SAMPLE ONLY

SECURED**SAMPLE ONLY**

DEFAULTING ON SECURED LOANS

As we learned on the previous page, loans are secured in a number of ways and they include security over the item(s) purchased using the borrowed money. In business this could involve personal guarantees, or security over company assets.

Having security is there for a reason.

Should the borrower not pay back the money borrowed as agreed to with the lender, then the lender has the right to seize the security/collateral and sell the security/collateral to pay for the money that has not been paid by the borrow (or enforce the personal guarantees).

Not paying back a secured loan is called 'defaulting on the loan'.

The implications on defaulting on secured loans can start with additional fees and interest being added to the outstanding loan amount and this only compounds the problem.

At some point, the lender will demand payment and this generally starts the process of seizing collateral. If personal guarantees were used then demands for payment are directed at the individuals. This can put a significant amount of pressure on personal finances.

Eventually, the lender will seize the security/collateral and sell the security/collateral to pay for the outstanding loan amount.

From both an individual and a business point of view, defaulting on a secured loan also leads to a bad credit score, making it far more difficult to get credit in the future.

The important thing to remember is that it costs money for lenders to try and recoup loan money through selling collateral or assets.

They are more inclined to renegotiate loan terms, extend payments, stop interest and fees being applied, in order to get the borrower back on track and pay off the loan.

SAMPLE ONLY

**Learning
Activity****SAMPLE ONLY****Task****LEARNING ACTIVITY FIVE**

In your own words tell us what the differences are between a secured loan and an unsecured loan.

TEACHER/TRAINER GUIDANCE NOTES

Answers will vary, but the differences between a secured loan and an unsecured loan are quite simple.

The term 'secured' means that the lender holds some type of security over the amount borrowed; also known as 'collateral' and an 'unsecured' loan has no collateral or security from the business, or the individual for money borrowed.

SAMPLE ONLY

**Learning
Activity****SAMPLE ONLY****Question****LEARNING ACTIVITY SIX**

- 1) What could happen if a borrower (individual or business) defaults on a secure loan?

- 2) What else could be affected if a borrower (individual or business) defaults on a secure loan?

TEACHER/TRAINER GUIDANCE NOTES

- 1) Should the borrower not pay back the money borrowed as agreed to with the lender, then the lender has the right to seize the security/collateral and sell the security/collateral to pay for the money that has not been paid by the borrower (or enforce the personal guarantees).
- 2) The individual's or business's credit score would be damaged.

SAMPLE ONLY

Section Three

Identify and Compare Costs of Using Credit